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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-1043

MILTON W. GARNATZ,
Plaintiff-Respondent,

v.

STIFEL NICOLAUS & CO., INC. and
KINGSLEY O. WRIGHT,
Defendants-Petitioners.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals
for the Eighth Circuit

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OPINIONS BELOW

There was no reported opinion in the district court, judgment was entered on the jury verdict, a copy of which judgment is appended hereto as Appendix A. The opinion of the United States Court of Appeals for the Eighth Circuit has been published at 559 F.2d 1357 (Appendix to advance sheet), attached hereto as Appendix B.

GROUNDS FOR JURISDICTION OF THIS COURT

Judgment was entered in the district court on December 2, 1976. A timely appeal was taken and the court of appeals for the Eighth Circuit affirmed judgment for plaintiff on November 1, 1977. Petition for rehearing en banc was denied November 23, 1977 and petition for rehearing was denied November 30, 1977.

This Court has jurisdiction to review the judgment of the Eighth Circuit pursuant to 28 U.S.C. § 1254(1.)

QUESTIONS PRESENTED FOR REVIEW

I. Did the Eighth Circuit err in holding that in an action brought under § 10(b) of the Securities Exchange Act of 1934 an individual who is induced to purchase publicly traded securities as a result of representations by a broker as to the prospective safety and return of the investment is entitled to rescissory damages equalling trading losses and declines in market value of retained securities as of the date of discovery of the alleged fraudulent representations.

II. In light of **Blue Chip Stamps v. Manor Drug Stores,** 95 S.Ct. 1917, 421 U.S. 723, 44 L.Ed.2d 539 (1975), did the Eighth Circuit err in holding that damages in a § 10(b) action are recoverable for losses suffered when the defendant broker allegedly induced plaintiff to refrain from liquidating his account, even though there was no purchase or sale of securities involved.

III. Did the Eighth Circuit err in declining to review petitioner's claim that plaintiff's cause of action under the Securities Act of 1934 was barred by the two year statute of limitations applied in the Eighth Circuit where plaintiff clearly admitted that he discovered the alleged fraud more than two years prior to filing suit.

STATUTES AND RULES

This matter involves § 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j) and Rule 10b-5 of the Securities and Exchange Commission (17 C.F.R. § 240.10b-5), attached hereto as Appendix C.

STATEMENT OF THE CASE

Plaintiff filed an action in the United States District Court for the Eastern District of Missouri in two counts alleging that he was induced to purchase corporate bonds on margin as a result of certain oral representations by petitioner Wright, a broker employed by petitioner Stifel, Nicolaus & Company. Count I was based upon 10(b) of the Securities Exchange Act of 1934 and § 17 of the Securities Act of 1933. Federal jurisdiction was alleged to arise under 28 U.S.C. § 1331 and 1337, 15 U.S.C. 77v(a) and 15 U.S.C. § 78aa. Count II was a pendent claim alleging common law fraud. The court of appeals limited its consideration to alleged violations of § 10(b) and Rule 10b-5 in affrming a jury verdict in favor of plaintiff.

Plaintiff opened a margin bond account at Stifel, Nicolaus in December 1972. Prior thereto plaintiff had had an extensive stock portfolio which had on the average yielded him a 3% return. Because of inflation he sought an investment in securities which would yield him a greater return. Through various investment seminars sponsored by Stifel, Nicolaus and meetings with petitioner Wright, plaintiff became interested in purchasing and did purchase on margin six corporate bonds which were selling at a discount from par value and which were traded on the New York Stock Exchange. The bonds were purchased on margin to take advantage of Missouri's then existing usury law which limited interest on broker's loans to 8%. Plaintiff pur-

chased bonds which yielded him a 12% - 14% return. Plaintiff was satisfied with his investments until about three or four months after his initial purchase the bonds started declining in value. The bonds, along with the entire securities market and national economy continued to decline in 1973 and 1974 as inflation and interest rates climbed to unprecedented levels.

Plaintiff filed suit on December 22, 1975.

Plaintiff claimed that he was fraudulently induced to purchase the bonds as a result of oral representations by petitioner Wright that:

> (1) all purchases had to be approved by the Board of Directors of Stifel, Nicolaus;
>
> (2) use of margin entails no risk to capital;
>
> (3) bonds purchased would not decrease in value more than one percent;
>
> (4) interest charged on margin would never exceed eight percent; and
>
> (5) the purchases would be without risk.

Petitioners denied that any such oral representations were made[1] and introduced substantial oral and written evidence that at the seminars plaintiffs attended contrary representations were made. Petitioners also asserted the legal defenses (1) that plaintiff had admitted discovering the alleged misrepresentations in May of 1973, more than two years prior to filing suit, and that his claim therefore was time-barred by the controlling two-year statute of limitations applied in the Eighth Circuit; (2) that under the prevailing law plaintiff could only recover the difference between the actual value of the securities purchased

[1] Even if representation (4) was made, it was a true statement in 1973 since Missouri had an 8% usury law, R.S. Mo. § 408.030, that was not repealed until August, 1974.

and their purchase price on the date of sale, and, since the actual value of the bonds equalled their purchase price, plaintiff was not entitled to recovery at all; and, (3) that the alleged misrepresentations related only to the "suitability" of the investments and as such the alleged misrepresentations were not actionable under the Federal securities laws.

Plaintiff testified that three or four months after he purchased the bonds, and at least by May 30, 1973, he realized that the value of his bonds had fallen by more than one percent and continued to decline thereafter. However, despite the fact that plaintiff admitted discovering by May 30, 1973 the falsity of alleged statements (2), (3) and (5), as set out above, the Eighth Circuit held that the May 30, 1973 discovery date did not toll the statute of limitations and therefore that plaintiff's action was not time-barred. The Eighth Circuit found that petitioner Wright's encouragements not to sell out after plaintiff discovered the risks in his investment somehow concealed the alleged fraud. (Appendix B, p. A-8). The Eighth Circuit held that there was no actual or constructive notice of the fraud until August 1974, when plaintiff admitted discovery, and allowed plaintiff to accrue his damages to that date for losses sustained in his bond account.

At the close of evidence, petitioners requested the following instruction on damages based upon the out-of-pocket rule of damages previously used in federal securities cases involving a defrauded purchaser:

> Should you find that defendant, Kingsley Wright, committed the acts stated in Instruction . . ., you shall award as damages to plaintiff, an amount representing the difference between the real value of the securities purchased or sold at the date of the purchase or sale and the price actually paid for the securities purchased or sold by plaintiff and such amounts that were spent that are legitimately attributable to defendant Wright's conduct. However, you shall

not award as damages amounts representing losses or unrealized gains due to speculation. The value of property is determined by the price at which it could be resold in an open market or by private sale if its quality or other characteristics which effect its value are known.

The trial court rejected petitioners' proposed instruction and instead gave the following instruction proposed by plaintiff:

> If you find in favor of the plaintiff, you shall award as damages to plaintiff, an amount representing the difference between the real value of the securities purchased or sold at the date plaintiff discovered or should have discovered the misrepresentations and the price actually paid for the securities purchased or sold by plaintiff and such amounts that were spent that are legitimately attributable to defendant's conduct.

The Eighth Circuit Court of Appeals criticized the damage instruction given by the district court as lacking clarity but held that the "jury quite properly ignored the mistake and proceeded to correctly determine plaintiff's damages." (Appendix B, p. A-10). Accordingly to the Eighth Circuit damages were properly measured by using a rescissory standard whereby "plaintiff is refunded his purchase price, reduced by any value received as a result of the fraudulent transaction. As applied to the case at bar, plaintiff can recover the decline in value of his bonds until his actual or constructive notice of the fraud . . ." (Appendix B, pp. A-6-A-7).

The court of appeals found that the following evidence had been introduced with regard to damages:

Sale of three bonds in December, 1973 for loss of	$22,600
Decline in value of other bonds in account by August, 1974	17,000
Commissions on transactions involved	6,000
Total	45,600

The jury verdict was for $45,000 and the Eighth Circuit held that the evidence as to losses sustained the verdict. However, the record further showed evidence that checks in the amount of $8,000 had been paid to plaintiff from his account. These cash payments were not credited against damages despite the Eighth Circuit's holding that damages represent loans "reduced by any value received as a result of the fraudulent transaction". (Appendix B, pp. A-6-A-7). The market value of the bonds retained by plaintiff when he closed his account were also not credited against his losses although the Eighth Circuit held that the purposes of its measure of damages was to "return the parties to the status quo ante the sale". (Appendix B, pp. A-6-A-7).

REASONS FOR GRANTING THE WRIT

I. The Eighth Circuit Erred in Awarding Rescissory Damages to Plaintiff—an Allegedly Defrauded Purchaser of Securities.

The measure of damages announced by the Eighth Circuit is in conflict with other circuits' decisions on the same issue. This case involves alleged misrepresentations by petitioners that caused plaintiff to purchase bonds traded publicly on the open market. Petitioners had no control over the price of the bonds nor over the frequency or volume of trading. Neither did petitioners exercise any control or influence over the companies which issued the bonds. Under such circumstances federal courts have traditionally applied an out-of-pocket measure of damages defined in *Estate Counseling Service, Inc. v. Merrill, Lynch et al.*, 303 F.2d 527, 533 (10th Cir. 1962), as follows:

> In the Federal courts the measure of damages recoverable by one who through fraud or misrepresentation has been induced to purchase bonds or corporate stock, is the difference between the contract price, or the price paid, and the real or actual value at the date of the sale, together with such outlays as are attributable to the defendant's conduct. Or in other words, the difference between the amount parted with and the value of the thing received.

This same rule has been expressed or recognized in *Harris v. American Investment Company*, 523 F. 220, 225 (8th Cir. 1975); *Foster v. Financial Technology, Inc.*, 517 F.2d 1068, 1071 (9th Cir. 1975); *Wolff v. Frank*, 477 F.2d 467, 478 (5th Cir. 1973); *Levine v. Seilon, Inc.*, 439 F.2d 328 (2d Cir. 1971); and, *Janigan v. Taylor*, 344 F.2d 781, 786 (1st Cir. 1965).

Such a rule accurately recompenses the purchaser for the difference in value of what he gave and what he received on the day he purchased his securities.

In the present case, however, the Eighth Circuit announces a rescissory measure of damages designed to return the parties to the status quo by returning to plaintiff his purchase price, reduced by value received as a result of the fraudulent transaction. Using this measure the Eighth Circuit permitted plaintiff to recover all losses on sales prior to his "discovery" in August, 1974 of the fraud and the decline in value of securities still held at the date of discovery. Such a rule of damages permits the investor to recover losses caused solely as a result of market and economic forces that are not under the control of the fraudulent seller. It is for this reason that those circuits which have considered the problem of fraudulent sales of securities, by persons not controlling the market in those securities, have used the out-of-pocket measure. Only by determining the difference between the price paid and real value of the securities at the date of purchase can damages be determined which have a causal relation with the basis of the cause of action—fraudulent inducement to purchase.

If the real value of the securities equals the purchase price, on the day of purchase, there are no damages since the investor receives what he pays for. *Hickman v. Groesbeck*, 389 F.Supp. 769, 779 (D. Utah 1974). Unlike a case involving a fraudulent purchase, petitioners in this case received no windfall profits which they could disgorge since they sold the bonds at market prices and the rescissory measure of damages merely shifts the investment risk from the investor to the broker. The Securities Exchange Act of 1934 was not designed to make a broker the guarantor of the investment of his customer.[2]

The Eighth Circuit relied upon the case of *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167 (2d 1970) for the proposition that the purchaser is entitled to recover the decline in value of

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[2] Plaintiff opened his account in December, 1972. The Eighth Circuit permitted losses to accrue to August, 1974. The period 1973 through 1974 constituted one of general and serious economic decline which could neither be foreseen nor controlled by petitioners.

his bonds until actual or constructive notice of the fraud. *Chasins* is not a persuasive precedent. First, it involved defendants who were market makers and underwriters with the ability to establish the prices of securities sold to plaintiff.[3] Second the same circuit that decided *Chasins* reaffirmed the out-of-pocket damage theory measured on the date of purchase, just one year after *Chasins* in the case of *Levine v. Seilon*, 439 F.2d 328, 334 (2d Cir. 1971). No mention of *Chasins* was made in *Levine*.

Finally, as applied, the rescissory measure of damages does not return the parties to the status quo. First, plaintiff opened his account by depositing stocks which were liquidated to buy bonds. Any decline in the value of his initial portfolio at the date of valuation of losses must be considered since plaintiff would have been exposed to the risk of loss on those stocks if he had not been induced by petitioners to purchase bonds. Second, plaintiff received cash payments of $8,000 from his bond account which were not credited against his losses even though the Eighth Circuit itself held that all losses must be "reduced by any value received as a result of the fraudulent transaction." (Appendix B, p. A-6). And, similarly, plaintiff held certain bonds on the date of valuation of losses but the market value of those bonds was not credited against trading losses.

The measure of damages established by the Eighth Circuit is contrary to the federal rule applied to defrauded purchasers suing under the Securities Exchange Act of 1934. Due to this conflict among the circuits, and due to the importance and novelty of the rule established by the Eighth Circuit, this Court should grant certiorari.

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[3] *Chasins*, at p. 1173, relies on the case of *Sarlie v. E. L. Bruce Co.*, 265 F. Supp. 371, 375-376 (S.D. N.Y. 1967) which dealt with a counterclaim for market manipulation, demonstrating the importance of the fact that defendant in *Chasins* was a market marker with ability to influence the market.

II. In Light of Blue Chip Stamps v. Manor Drug Stores the Eighth Circuit Erred in Awarding Damages Arising From Inducements to Retain Securities.

In the case of *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737, 95 S.Ct. 1917, 1926 (1975), this Court held that a civil cause of action for violation of Rule 10b-5 and § 10(b) of the Securities Exchange Act of 1934 will lie only where there is an actual purchase or sale of securities. Investors are specifically barred from bringing actions under that rule and statute if they merely "allege that they decided not to sell their shares because of an unduly rosy representation or a failure to disclose unfavorable material." *Id.* The opinion of the Eighth Circuit in this case flies in the face of that rule when it permits plaintiff to recover damages arising from inducements to retain his bonds after he discovered the falsity of the initial representations regarding the safety of his investment.

Plaintiff alleged that he purchased the bonds because he was told they constituted a safe, risk-free investment. By May 30, 1973 plaintiff realized that the value of his bonds had fallen contrary to the initial representations of safety. Petitioners contend that, assuming the out-of-pocket measure of damages is denied, losses to plaintiff must be established no later than May 30, 1973.

But, the Eighth Circuit implied an additional ground of recovery—neither pleaded nor tried by plaintiff—to permit plaintiff's damages to accrue to August, 1974. The court stated that although facts relating to the falsity of the original representations of safety were known by plaintiff at an earlier date, was entitled nonetheless, to recover damages to August, 1974 as a result of subsequent representations by petitioner Wright:

> Every opportunity for plaintiff's discovery of defendants' fraud was met by the convincing reassurances of Wright. (Appendix M, p. A-8).

and

> During this period [late 1972 to April 3, 1973], Wright repeatedly reassured Garnatz that the drop [in bond prices] was only temporary and strongly recommended that plaintiff stay with the program, which he did. (Appendix B, p. A-4).

It is clear that the Eighth Circuit permitted plaintiff to recover losses sustained as a result of alleged inducements to *retain* his account after the initial representations of safety were proved incorrect. Such losses arise solely as a result of retention of securities, no purchase or sale was involved. Under the language of § 10(b) and Rule 10b-5, as interpreted by *Blue Chip Stamps*, supra, plaintiff could not plead as the basis of his suit that he was damaged as a result of inducements to retain securities—certainly such inducements should not be permitted to support a jury award.

This precise problem was recognized in *Musser v. Bache & Co., Inc.*, CCH, Fed. Sec. Rptr. ¶ 96,183 (N.D. Calif. 1977). In that case plaintiff purchased stock and when the price of the stock began to fall defendant dissuaded plaintiff from selling. Relying on *Blue Chip Stamps*, the district court granted summary judgment in favor of defendant.

In the present case there was no continuity of causation between the original inducements to purchase and the subsequent inducements to retain the account. The fact that his investment entailed risk to capital, that it could fall in value more than one per cent and that it was not risk free, contrary to the alleged representations, was discovered by plaintiff by May 30, 1973, if there was not such a discovery there would be no need for additional inducements to retain the bonds in light of falling prices. The alleged inducements not to sell bonds constitute separate and independent factual circumstances and, insofar as they did not involve a purchase or sale of securities, and were

not even submitted to the jury in the trial court's instructions, the Eighth Circuit erred in permitting recovery of damages thereon under § 10(b) and Rule 10b-5.

III. The Eighth Circuit Erred in Declining to Review Petitioner's Claim That Plaintiff's Cause of Action Under the Securities Exchange Act of 1934 Was Barred by the Applicable Statute of Limitations.

Plaintiff filed this lawsuit in the United States District Court for the Eastern District of Missouri on December 22, 1975. The federal claims were based on allegations of violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Act of 1934, neither of which sections provides for a specific statute of limitations. The federal securities law violation was submitted to the jury on a theory of violation of § 10(b).

Plaintiff's bond margin account was opened with petitioner Stifel, Nicolaus on December 29, 1972, and plaintiff purchased six different bond issues between January 3 and February 5, 1973. Plaintiff's complaint claimed that he purchased these bonds on the basis of certain alleged misrepresentations made to him at meetings with petitioner Wright in December of 1972. Plaintiff claimed that petitioner Wright falsely represented to him that these bonds were a safe, risk-free investment and that they would not decline more than one percent in value. Plaintiff admitted in trial that he discovered the statements were false no later than May 30, 1973, since by that date he realized, contrary to the alleged misrepresentations, that the value of his bonds had declined substantially more than one percent and were not therefore risk-free.

Prior to the trial of this cause, petitioners filed a motion to dismiss on the grounds *inter alia* that under the controlling law in the Eighth Circuit, *Vanderboom v. Sexton*, 422 F.2d 1233 (8th Cir. 1970), the lawsuit was barred by Missouri's two year Blue Sky statute of limitations, R.S.Mo. § 409.411(e). In 1970, the Eighth Circuit in *Vanderboom* held that Arkansas's Blue Sky statute of limitations, and not its common law fraud statute of limitations, applied to 10(b)-5 actions. The Arkansas statute is virtually identical to the Missouri statute. The District Court herein overruled this motion on the grounds that *Ernst & Ernst v. Hochfelder*, 96 S.Ct. 1375 (1976), imposed scienter as a necessary element of a § 10(b) cause of action and, therefore, that section became more analogous to a common law fraud action than to a Missouri Blue Sky action. The District Court concluded that the applicable statute of limitations was five years pursuant to Missouri's common law fraud statute, R.S.Mo. § 516.120. Petitioners renewed their position on the statute of limitations in their motions for directed verdict filed at the close of plaintiff's case, at the close of all the evidence, and in their motion for new trial. The District Court overruled all petitioner's motions in this regard and, because the acts alleged in plaintiff's petition were clearly within Missouri's five year common law fraud statute of limitations, the District Court did not give an instruction to the jury relating to the statute of limitations.

On appeal to the Eighth Circuit, petitioners again maintained that plaintiff's action was barred by Missouri's two year Blue Sky statute of limitations. Petitioners maintained that even if, under federal law, that statute is tolled pending discovery of the alleged fraud, plaintiff had unequivocally and openly admitted discovering the alleged untruths more than two years prior to filing suit. Plaintiff had testified that on or before May 30, 1973 he knew, from the decline in the market value of his

bonds, that the representations he relied on in purchasing the bonds were not true and petitioners asserted they were at least entitled to an instruction on the statute of limitations.[4]

The Eighth Circuit first held that plaintiff did not discover the fraud on May 30, 1973 because petitioner Wright, by advising plaintiff not to sell out when the bonds dropped in value, was somehow concealing the fact that the bonds had declined in value contrary to the alleged representations. The Eighth Circuit reached this conclusion even though plaintiff had not pleaded these representations and the jury had not been instructed upon them.

The Eighth Circuit also concluded that the jury "apparently found" the date of discovery to be in August 1974. This holding was based upon the damage instruction, objected to by petitioners, that the jury could award as damages the difference between plaintiff's purchase price and the real value of the securities "on the date plaintiff discovered or should have discovered the misrepresentations." The Court of Appeals held that because plaintiff sought damages in the amount of $45,000.00, and because these were the amount of his losses as of August 1974, the jury found that on this date plaintiff discovered or should have discovered, the alleged fraud. That presumption is erroneous. Furthermore, the Eighth Circuit admitted that the jury did not follow the instructions as given to them as the jury did not value all of the securities on one date as instructed, but rather valued all losses on sales prior to the date of discovery. If the jury did not follow the instruction in this regard, how can

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[4] Petitioners did not offer a two year statute of limitations instruction based on plaintiff admission of discovery on May 30, 1973. The District Court had held the five year common law fraud statute applicable and it would have been a useless act to tender a two-year instruction. Petitioners not tendering such an instruction and failure to object to its being given does not preclude appellate review. *Robinson v. Heilman*, C.C.H. Fed. Sec. L. Rptr., ¶ 96,233 (9th Cir. 1977).

the Eighth Circuit contend that they followed the instruction with regard to even determining a date of discovery in the first instance? Thus the Eighth Circuit's presumption that the jury determined the date of discovery from the instruction as given is manifestly erroneous.

The Eighth Circuit, then, utilized the well-settled doctrine that the state statute of limitations applicable to federal securities law is not tolled until such time as the fraud is or should be discovered. Finding on the basis of the damage instruction that the fraud was discovered in August of 1974 and the action was filed in December 1975, the Eighth Circuit found it unnecessary to review whether *vel non* Missouri's Blue Sky two year statute of limitations was still applicable in the Eighth Circuit and barred plaintiff's action.

Petitioners submit that the Eighth Circuit erroneously construed the damage instruction and the jury's verdict thereon and thereby failed to review petitioner's assertion that plaintiff's action was barred by the two-year statute of limitations. Petitioners further submit that the District Court's ruling that subsequent to *Ernst & Ernst* state common law fraud statutes should be applied to § 10(b) actions was in error and that by this ruling petitioners were erroneously precluded from submitting a statute of limitations instruction to the jury.

Subsequent to the order of the District Court entered on May 18, 1976, the United States Court of Appeals for the Seventh Circuit and the District of Columbia issued opinions stating that, regardless of the ruling in *Ernst & Ernst v. Hochfelder*, a cause of action brought under Section 10(b) of the Securities Exchange Act of 1934 and Section 17(a) of the Securities Act of 1933 is properly governed by the applicable state Blue Sky Law Statute of Limitations. The two cases support and reaffirm the holding of this court in *Vanderboom v. Sexton*, 422 F.2d 1233

(8th Cir. 1970)—decided prior to *Hochfelder*—that the two year limitation provided by the Missouri Blue Sky Law, R.S. Mo. Section 409.411(e), must govern this action.

The most recent of these two cases is *Forrestal Village v. Graham*, 551 F.2d 411 (D.C. Cir. 1977). That case was pleaded under Section 17(a) of the 1933 Act and Section 10(b) of the 1934 Act, the same sections relied upon by plaintiff herein. The plaintiff in *Forrestal Village* also joined a cause of action for common law fraud, breach of fiduciary duty and waste of assets. The district court granted summary judgment on the federal claims, applying the two year statute of limitations of the District of Columbia Blue Sky Laws and also dismissed the state claims for lack of federal jurisdiction. The Court of Appeals affirmed the summary judgment and dismissal and held that in choosing a statute of limitations for these sections of the federal securities acts, it is necessary to determine the limitation which "best effectuates the federal policy" expressed in the 1933 and 1934 Acts. The court noted that the alternative choices it had were the District of Columbia common law fraud statute of limitations and the District's blue sky limitations. *Forrestal* elected to adopt the District of Columbia blue sky limitation and expressly adopted the reasoning in *Vanderboom v. Sexton*, supra. It noted that state blue sky laws deal expressly with the sale of securities rather than with general fraudulent transactions and, therefore, are more closely related to the 1933 and 1934 securities act. The court dismissed the argument that the *Hochfelder* requirement of scienter, standing alone, could invalidate the use of blue sky statute of limitations because "this possible difference between the federal statute and the local statute is easily outweighed by their similarities in both purpose and substance" (at p. 91,005).

The same result was reached in *LaRosa Building Corp. v. The Equitable Life Assurance Society of the United States*, 542 F.2d 990 (7th Cir. 1976). In that case, which also relied upon the *Vanderboom* case, the Seventh Circuit elected to apply

to a cause of action pleaded under Section 10(b) of the 1934 Securities Exchange Act, the Indiana two year statute of limitations contained in that state's blue sky law rather than the six year statute of limitations applicable to fraud. Again, the basis for the decision was that state securities statutes more clearly parallel Section 10(b) than did common law fraud theories.

Furthermore the mere fact that scienter is now required for a 10b-5 action does not itself require application of a longer statute of limitation. In fact, a review of the Securities Acts of 1933 and 1934 indicates that Congress intended the applicable statutes of limitations to be both narrow and independent of any scienter requirement. Those sections of the 1933 and 1934 Acts which contain specific periods of limitation restrict actions to those brought within one year of discovery of the violation or within three years of the occurrence regardless of whether the particular violation requires proof of scienter or mere negligence. In the 1934 Act, sections 9(a) (purposeful manipulation of securities prices), 18 (knowing false or misleading statements in registration materials), and 29(b) (contracts for the purchase or sale of securities entered into by brokers or dealers using manipulative, deceptive or fraudulent devices) adopt the above limitation which is shorter than the five year fraud limitation in Missouri. Section 13 of the 1933 Securities Act provides the same limitation for negligent conduct including filing false or misleading registration information (§ 11) or making untrue statements of material fact or omissions of material fact (§ 12(2)).

Analysis of these federal statutes of limitation indicates that there is no apparent congressional intent that violations involving greater "fault" should carry with them a longer limitation period, and the new requirement of scienter for § 10(b) does not mandate an automatic enlargement of the time in which suit may be filed. The similarity between the federal laws and the state Blue Sky laws, and the lack of relation between scienter and the length of the limitations expressed in Federal Securities

Acts indicate that the commonality of purpose doctrine is a more cogent rationale than the scienter principles for choosing applicable state statutes of limitations. The two-year limitation period contained in the Missouri Blue Sky statute is closer to the specified federal limitation periods and, therefore, better effectuates federal policy as expressed in the Securities Acts of 1933 and 1934 than does the five-year fraud limitation. *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123, 127 (7th Cir. 1972); *Newman v. Prior*, 518 F.2d 97, 100 (4th Cir. 1975).

The Eighth Circuit has properly identified state Blue Sky statutes as having a commonality of purpose with § 10(b) of the Securities Exchange Act of 1934 to the exclusion of fraud statutes. This conclusion is sound in law and logic and is not invalidated by the mere addition of scienter as an element to a 10(b) cause of action.

Ernst & Ernst does not, as the District Court held, dictate application of state common law fraud statutes to § 10(b) actions. The Courts after *Ernst & Ernst* have held that the state Blue Sky statutes of limitations apply to § 10(b) actions. Plaintiff's admission here that he discovered the alleged fraud more than two years prior to filing suit renders his action time-barred. Petitioners are entitled to reversal, or in the alternative, a remand to the Eighth Circuit for consideration of whether Missouri's Blue Sky statute of limitations bars plaintiff's action.

Respectfully submitted,

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APPENDIX

APPENDIX A

United States District Court, Eastern District of Missouri

Eastern Division

Milton W. Garnatz,	Plaintiff,	Civil Action File No. 75-1161 C (1)
vs.		
Stifel, Nicolaus & Company, Incorporated		
and		
Kingsley Wright, Sr.,	Defendants.	

JUDGMENT

(Filed in U.S. District Court December 2, 1976)

This action came on for trial before the Court and a jury, Honorable James H. Meredith, District Judge, presiding, and the issues having been duly tried and the jury having rendered its verdict,

It is Ordered and Adjudged that the plaintiff, Milton W. Garnatz recover of the defendants, Stifel, Nicolaus & Company, Inc., and Kingsley Wright, Sr., the sum of $45,000.00 with interest thereon at the rate of 6% per annum and costs.

Dated at St. Louis, Missouri, this 2nd day of December, 1976.

WILLIAM D. RUND
Clerk of Court

By ROBERT R. BOUSMAN
Deputy Clerk

APPENDIX B

United States Court of Appeals for the
Eighth Circuit

No. 77-1048

Milton W. Garnatz,
Appellee,
v.
Stifel, Nicolaus & Co., Inc., and
Kingsley O. Wright,
Appellants.

Appeal from the United States District Court for the Eastern District of Missouri

Submitted: September 15, 1977
Filed: November 1, 1977

Before VAN OOSTERHOUT and MATTHES, Senior Circuit Judges, and STEPHENSON, Circuit Judge.

MATTHES, Senior Circuit Judge.

Stifel, Nicolaus & Co., a brokerage firm, and Kingsley O. Wright, a vice-president of that firm, appeal from a judgment entered against them on a jury verdict awarding Milton W. Garnatz damages of $45,000 with interest and costs. Count I of plaintiff's complaint was based on defendants' alleged violations of § 10(b) of the Securities Exchange Act of 1934, 15

U.S.C. § 78j(b); Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5; and § 17 of the Securities Act of 1933, 15 U.S.C. § 77q. Count II of the complaint was a pendent state claim for common law fraud.

Defendants press various contentions regarding the measure of damages, the sufficiency of the evidence, and the statute of limitations. We hold that the damages in this case were correctly measured and were supported by the evidence, and that plaintiff's action was timely.

I

Garnatz is a man of limited education and modest means. His familiarity with the securities markets is characteristically that of the average, individual investor, not the sophisticated trader.

In November of 1972, plaintiff attended a series of investment seminars sponsored by Stifel, Nicolaus. On the basis of representations made at those seminars and at two personal meetings with Kingsley Wright, plaintiff agreed to participate in a special bond margin account program which was purportedly designed to maximize his income while preserving his capital. The representations plaintiff specifically relied on in deciding to join in the program were: (1) that all purchases had to be approved by the board of directors of Stifel, Nicolaus; (2) that the use of a margin account entailed no risk to plaintiff's capital; (3) that the bonds purchased would not decrease more than one percent in value; (4) that the interest rate on the margin account would never exceed eight percent; and (5) that defend-

ants' recommended purchases would be without risk. Defendants do not seriously challenge the allegation that these representations were both false and material.

Plaintiff insisted on avoiding speculation, yet most of the bonds purchased for him were either low-rated or non-rated by Standard & Poors. Although safety was a key feature of defendants' sales pitch, in order to pay the interest rate on the margin account and still provide a sufficiently attractive return, it was apparently necessary to purchase high-yield, and consequently highly-speculative, bonds. At no time was any bond purchase approved by the board of directors of Stifel, Nicolaus.

Plaintiff entered into the program in late 1972. By April of 1973, the market value of Garnatz' account had declined over one percent. As a result, plaintiff was forced to relinquish all income from the bonds to pay increased margin calls. During this period, Wright repeatedly reassured Garnatz that the drop was only temporary and strongly recommended that plaintiff stay with the program, which he did. In August of 1974, the interest rate on the margin account jumped from eight percent to thirteen percent, as permitted by a change in Missouri's usury law. Garnatz does not dispute the fact that by that time he was, or should have been, on notice of the fraud.

II

The implication of a private damage remedy for violations of the federal securities laws is based partly on the notion that the abrogation of a statutorily imposed duty is tortious. 1 A. BROMBERG, SECURITIES LAW: FRAUD § 2.4 (1977). Following the model of the common law tort of deceit, in § 10 (b) and Rule 10b-5 actions "the defendant is liable to respond in such damages as naturally and proximately result from the

fraud . . ." *Estate Counselling Service v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527, 533 (10th Cir. 1962). Normally, federal courts measure those damages according to the out-of-pocket rule. *Harris v. American Investment Co.*, 523 F.2d 220, 224-26 (8th Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976). As applied to a fraudulently induced purchase of securities, that rule provides for the recovery of the difference between the actual value of the securities and their purchase price. *Id.* at 225. Recovery is also allowed for any consequential damages proximately resulting from the fraud. D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 601-06, 615 (1973); *see Estate Counselling Service v. Merrill Lynch, Pierce, Fenner & Smith, Inc., supra.* The rule was designed to provide plaintiffs with a compensatory recovery rather than allowing damages for a lost expectancy. D. DOBBS, *supra* at 595; *see Harris, supra* at 225. It works best in the typical situation where the defendant's fraud conceals the actual value of the item purchased, yet does not affect the overall market value of that item. *See id.* at 225-26.

Of course, the out-of-pocket rule is not a talisman. Indeed, this court has shown no hesitation in varying that measure when necessary on the facts of a given case. *See, e.g., Myzel v. Fields*, 386 F.2d 718, 745 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968) (difficulty in ascertaining actual value). Our function is to fashion the remedy best suited to the harm.

In the present case, defendants urge strict application of the out-of-pocket rule. They would deny plaintiff any recovery at all, since the value of the bonds equalled their purchase price. But the fact that plaintiff got what he paid for does not mean he did not suffer any legally cognizable injury from defendants' fraud. It merely indicates that the fraud did not relate to the price of the bonds.

A similar problem was presented in *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167 (2d Cir. 1970). In that case, the defendant's failure to reveal its market-making status with respect to the securities it recommended to the plaintiff for purchase was held to be a material omission in violation of Rule 10b-5. Under a traditional application of the out-of-pocket rule, the plaintiff would have recovered nothing, since the price paid was equal to the fair market value of the stocks. However, the court recognized that

> the evil is not the price at which [plaintiff] bought but the fact of being induced to buy and invest for some future growth in these stocks without disclosure . . .

Id. at 1173. Since the plaintiff had sold his stock prior to discovering the fraud, the court allowed recovery of the difference between his purchase price and his resale price.

As in *Chasins*, the gravamen of the present action was not whether Garnatz bought the bonds for a fair price, but that he bought at all. Absent defendants' representations regarding the safety of the program, plaintiff's express disdain for speculation undoubtedly would have precluded his participation; but the fraudulent promise of a low-cost, income-maximizing, and risk-free investment package overcame plaintiff's caution. Under these circumstances, we believe that a rescissory damage measure, similar to that employed by the court in *Chasins*, is appropriate. *See* Cobine, *Elements of Liability and Actual Damages in Rule 10b-5 Actions*, 1972 Ill.L.F. 651, 672-73; Comment, *The Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities*, 26 Stan.L.Rev. 371, 374-77 (1974). Such a measure seeks to return the parties to the status quo ante the sale. In effect, the plaintiff is refunded his purchase price, reduced by any value received as a result of the fraudulent transaction. As applied to the case at bar, plaintiff can recover the decline in value of his bonds until his actual or constructive

notice of the fraud, as well as any other losses properly attributable to defendants' wrongdoing.[1] That decline in value is determined by the losses taken on bond sales plus the losses sustained on bonds held,[2] as long as all such losses were incurred prior to the date that plaintiff knew, or should have known, of the fraud.

Some would argue, as defendants have here, that a rescissory measure of damages allows recovery of losses due to market forces rather than the defendants' conduct. *See Green v. Occidental Petroleum Corp., supra* n. 1, at 1342. We recognize that neither Stifel, Nicolaus nor Kingsley Wright caused plaintiff's bonds to decline in value. But plaintiff's purchase of these low-rated and non-rated bonds was induced by defendants' wrongful concealment of the risks normally attendant to such transactions. Those risks should therefore rightly be borne by defendants. Moreover, since plaintiff's losses were natural, proximate, and foreseeable consequences of defendants' fraud, the causa-

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[1] Several theoretical bases support the result we reach in this case. *See, e.g.*, D. DOBBS, *supra* at 614-18 (recovery of decline in market value as consequential damage award); F. HARPER & F. JAMES, THE LAW OF TORTS, 598-603 (1956) (out-of-pocket rule, but actual value determined in light of subsequent events or as of post-transaction date); *Green v. Occidental Petroleum Corp.*, 541 F.2d 1335 (9th Cir. 1976) (Sneed, J., concurring in part) (rescissory damages).

We decline to adopt any one perspective. Given the atypical nature of this litigation ". . . it would be unwise to set forth a uniform rule with broad application to all securities cases." *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90, 105 (10th Cir.), *cert. denied*, 404 U.S. 1004 (1971). Moreover, the flexibility of our case-by-case approach is well-suited to the catch-all nature of § 10(b) and Rule 10b-5. *See Myzell v. Fields, supra* at 748-49; Cobine, *supra* at 652; Note, *Rule 10b-5 Damages: The Runaway Development of a Common Law Remedy*, 28 U.Fla.L.Rev. 76, 77-78 (1975); Comment, *Measurement of Damages in Private Actions Under Rule 10b-5*, 1968 Wash.U.L.Q. 165, 175.

[2] The fact that plaintiff apparently retained most of the bonds he bought from defendants is not fatal here, as it would be in a case of strict rescission, since allowance has been made against the refunded purchase price for the value of the bonds in plaintiff's hands. *See Green v. Occidental Petroleum Corp., supra* at 1343.

tive connection is sufficient. Of course, the responsibility for losses incurred after actual or constructive notice of the fraud must fall to plaintiff.

III

We turn now to the evidence supporting the jury's verdict, drawing all reasonable inferences in plaintiff's favor.

A. **Actual or Constructive Notice of the Fraud**

Wright admitted that Garnatz suffered losses of $22,600 on the sale of three of his bonds in December of 1973. He further admitted, and documentary evidence established, that by August, 1974, the market value of Garnatz' other bonds had dropped nearly $17,000. Commissions[3] on the various transactions involved were over $6,000. Thus, plaintiff's losses as of August, 1974, totalled just over $45,000. As that is also the figure awarded by the jury, and since the jury was instructed not to award damages for the period after the plaintiff had actual or constructive notice of the fraud, it is apparent that the jury believed that he did not have such notice prior to August of 1974.

Defendants argue that plaintiff should have discovered the fraud no later than May 30, 1973, since by that date the value of his bonds had declined more than one percent. Defendants maintain that their liability should be limited to losses accrued as of that date. We do not find this argument compelling.

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[3] Defendants do not challenge the inclusion of commissions as an element of plaintiff's damages. *See Madigan, Inc. v. Goodman*, 498 F.2d 233, 239 (7th Cir. 1974). Consequently, we do not address the question of whether *vel non* the recovery of commissions is appropriate where the object of the fraud is retained by the injured party.

Every opportunity for plaintiff's discovery of defendant's fraud was met by the convincing reassurances of Wright. The same factors which originally induced plaintiff's trust continued to operate in perpetuation of the fraud. Impressed by the reputation of Stifel, Nicolaus and persuaded by Wright to expect the eventual fulfillment of the bond program's promise, Garnatz did not recognize the signals that could have provided early warning. Defendants should not complain that their fraud was so successful. We hold that on these facts, the jury's apparent finding that plaintiff had neither actual nor constructive notice of the fraud until August of 1974 was reasonable and supported by the evidence.

B. **Damages Awarded**

The district court charged the jury, in part, as follows:

> If you find in favor of the plaintiff, you shall award as damages to the plaintiff, an amount representing the difference between the real value of the securities purchased or sold at the date plaintiff discovered or should have discovered the misrepresentations and the price actually paid for the securities purchased or sold by plaintiff and such amounts that were spent that are legitimately attributable to defendant's conduct.

Defendants maintain that under this instruction, the jury could consider evidence of plaintiff's losses as of a single date only —the date of actual or constructive notice of the fraud. Thus, defendants argue that the jury could allow plaintiff to recover either his December, 1973 losses on bonds sold, or his August, 1974 losses on bonds retained, but not both. Because the amount of the verdict clearly includes all of plaintiff's bond losses prior to his notice of the fraud, defendants conclude that the jury improperly ignored the district court's charge, and that defendants' motion for a new trial was therefore erroneously denied.

We disagree with defendants' narrow reading of the district court's instructions. Though not a model of clarity, when taken as a whole and in light of the evidence before the jury, we believe the instructions permitted plaintiff to recover for both his December, 1973 losses on bonds sold and his August, 1974 losses on bonds retained. *See Alabama Great Southern R. Co. v. Chicago & N. W. Ry. Co.*, 493 F.2d 979, 986 (8th Cir. 1974). In any event, defendants made no effort to secure a clearer instruction by the district court. As the Supreme Court has noted:

> Appellate courts are not inclined to grant a new trial on account of an ambiguity in the charge to the jury, where it appears that the complaining party made no effort at the trial to have the matter explained.

Spring Co. v. Edgar, 99 U.S. 645, 659 (1878).

This does not appear to us to be a case where the jury was at all confused as to the damages suffered by plaintiff. Indeed, assuming *arguendo* that the district court's instruction erroneously limited plaintiff's recovery to either his December, 1973 losses or his August, 1974 losses, the jury quite properly ignored the mistake and proceeded to correctly determine plaintiff's damages. A jury's failure to follow the trial court's erroneous instructions is not a sufficient ground for a new trial if it is otherwise clear that the verdict is just. *Lazier Gas Engine Co. v. Du Bois*, 130 F. 834, 839 (3d Cir. 1904); 6A MOORE'S FEDERAL PRACTICE ¶ 59.08[4], at 59-140 (2d Ed. 1974).

We have carefully reviewed defendants' other challenges regarding the damage award and find them to be without merit. We hold that the jury's verdict was supported by the evidence and that the district court did not abuse its discretion in denying defendants' motion for a new trial. *See United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 247-48 (1940).

IV

Defendants' final contention concerns the timeliness of plaintiff's suit. At the outset, we note that there is no federal statute of limitations applicable to § 10(b) and Rule 10b-5 actions. Rather, federal courts borrow that statute of limitations of the forum state which "best effectuates the federal policy at issue." *Vanderboom v. Sexton*, 422 F.2d 1233, 1237 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970), *quoting Charney v. Thomas*, 372 F.2d 97, 100 (6th Cir. 1967); *see Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 n.29 (1976).

At the trial of the present case, defendants moved to dismiss the complaint on the ground that it was time-barred. The district court denied the motion in a memorandum opinion holding that the five-year Missouri statute of limitations for common law fraud applied and that plaintiff's action was timely under that statute. The choice of Missouri's common law fraud statute of limitations was a departure from the general rule in this circuit that a forum state's blue-sky statute of limitations is normally applicable to § 10(b) and Rule 10b-5 actions. *See Vanderbloom v. Sexton, supra* at 1238. However, the district court held that the *Vanderboom* rule had been impliedly overruled by the Supreme Court's decision in *Ernst & Ernst v. Hochfelder, supra*, requiring scienter in § 10(b) and Rule 10b-5 actions. Defendants urge that the district court's holding in this regard was erroneous, and that the two-year Missouri statute of limitations for blue-sky violations should govern the present case.

Since we hold that plaintiff's cause of action is timely under *either* the Missouri blue-sky or the Missouri common law fraud statute of limitations, we need not, and therefore do not, decide which of those statutes of limitations applies in post-*Ernst* § 10(b) and Rule 10b-5 actions.

It is well settled that the statute of limitations applicable to actions under the federal securities laws is tolled until such time as the fraud is, or should be, discovered. *Vanderboom*, *supra* at 1240. As we have seen, the jury in the present case apparently found that Garnatz discovered, or should have discovered, the fraud as of August of 1974. That finding is supported by the evidence. Plaintiff's complaint was filed in December of 1975—well within even the two-year Missouri blue-sky statute of limitations pressed by defendants. Thus, plaintiff's action was not time-barred.

V

Our decision of this case on federal grounds relieves us of the task of reviewing plaintiff's state law claim. We thereby avoid any unnecessary decision on matters of Missouri law.

Defendants have failed to convince us that the verdict of the jury in this case was incorrect or that the district court committed any prejudicial error. Accordingly, we affirm the judgment.

A true copy.

Attest:

Clerk, U.S. Court of Appeals, Eighth Circuit.

APPENDIX C

SECURITIES EXCHANGE ACT OF 1934

Regulation of the Use of Manipulative and Deceptive Devices

Section 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5. Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.